In the Supreme Court
OF THE
United States

OCTOBER TERM, 1942

No.

E. J. THOMAS, J. R. MCDONALD, J. R. MASON, E. G. WILLIAMS and A. C. CARPY,
Petitioners,

vs.

EL DORADO IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

FACTUAL BACKGROUND OF THE CASE.

A statement of the facts surrounding the case is made in the preceding petition.

I. THE PLAN OF COMPOSITION DISCRIMINATES UNFAIRLY AGAINST THE APPELLANTS WHO ARE CREDITORS OF THE PUBLIC DEBTOR AND IN FAVOR OF THE RECEIVER OF THE CALIFORNIA NATIONAL BANK. THE PREFERENCE IN FAVOR OF THAT CREDITOR CONSTITUTES LACK OF GOOD FAITH.

In *Luehrmann v. Drainage Dist. No. 7,* 104 Fed. (2d) 696, 308 U. S. 604, which was the first important case on the question of consent involving the Reconstruction Finance Corporation and in which case certiorari was denied by this Court, a case which has been repeatedly cited by other Courts and by the Court below, one of the contentions made was that the bondholders who had already scaled their debt before the petition was filed could not be counted as acceptors of the plan. The Court declared: "it is apparent that all parties to the transaction acted upon the understanding that the disbursements made were in conformity with the plan of readjustment then in process under the first Act and later continued in substance under the second Act." And for this reason these classes of bondholders retained their original status and were entitled to be counted acceptors of the plan.

In the case of *Bekins v. Lindsay Strathmore Irrigation District,* 114 Fed. (2d) 680 at 684 the lower Court quoted with approval the language of the District Court as follows:

> "we think it clear that the R. F. C. loaned its money for the benefit of the district and that the district accepted the financial help from the R. F. C. with the joint central purpose and mutual intent that all outstanding bonds be kept alive until such time as R. F. C. determined that the

> project of bond debt reduction agreed to had been attained,"

A transaction which took a period of some six years.

It would seem quite obvious that all of the rules regarding good faith, discrimination, unfair or double dealing should be kept alive and operative during all of this period of time, and would not be cut off by the operation of 11 U. S. C. Section 96. The filing of the petition has nothing whatever to do with the undertaking of the plan of composition because obviously the district has to have its 51% before it files the plan, and it may have been soliciting those consents over a long period of time. It was said by the lower Court in *West Coast Life v. Merced Irrigation District,* 114 Fed. (2d) 654 at 666:

> "It may be safely stated that from the date last mentioned up to the first suggestion of relief through R.F.C. and thereafter, the problem has been a continuous one of refinancing for the district."

This was a long period of time.

Subdivision j of Section 403 (11 U. S. C.) was enacted for the very purpose of creating the legal fiction that "The partial completion or execution of any plan of composition as outlined in any petition filed under the terms of this title by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the

effect of this title, and the written consent of the holders of any securities outstanding as the result of any such partial completion or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition." 114 Fed. (2d) at 667.

The defeated parties in the *West Coast Life* case argued that subdivision j was not enacted until after the R. F. C. had acquired the bonds. The Court cited the *Luehrmann* case, supra, and pointed out that in that case as in the *Merced* case it was provided that the outstanding bonds should not be cancelled until refinancing was complete, and the question was whether the old bonds were still outstanding. The Court in the *West Coast Life* case at page 668 refers to the discussion in Congress where the committee pointed out that before the Act went into effect there were a number of municipalities which engaged in partial refunding, and in the absence of this new law they would be "completely at the mercy of a recalcitrant minority", and so passed subdivision j to get around the decision in *City of West Palm Beach,* 96 Fed. (2d) 85, holding that consenters to an executed plan out of Court cannot come into Court and consent. But the Ninth Circuit Court declared: "However, the section does provide that the partial completion of a plan 'shall not be construed as limiting or prohibiting the effect of this title'."

The main point here is that the plan is still in course of being accepted.

To arrive at the conclusion that the payment of 82½% to the California National Bank does not vitiate the plan of composition because it is unequal treatment in favor of one creditor, repudiates and destroys the very basis upon which the consents to the plan are considered valid in every previous case.

We take it that it is well established that the plan of composition in these cases is a continuing transaction which may have been commenced before the enactment of the municipal bankruptcy act, but is nevertheless a plan of composition and so the consents are good. It is not thinkable that the Court would adopt a theory of the continuity of the plan of composition in order to validate the consents on the one hand and then hold that because a claim was paid the 82.5% February 5, 1937 which was more than one year prior to the filing of the bankruptcy petition it does not constitute a preference under Stat. 11 U. S. C. A. Sec. 96 when 90% were paid the composition figure of 50.5% in 1933-35. The plan cannot be a continuing plan for one purpose and not be a continuing plan for another purpose.

Furthermore, bad faith is shown by the whole transaction. *Roberts v. Board of Public Instruction,* 117 Fed. (2d) 943; *U. S. v. Greer Dr. Dist.,* 121 Fed. (2d) 675; *Clarke v. White,* 12 Pet. 178, 9 U. S. (L. Ed.) 1046; *Zavelo v. Reeves,* 227 U. S. 625; *Texas Hotel Corp. v. Waco Dev. Co.,* 87 Fed. (2d) 395, 399; *John Hancock Mutual Life Insurance Co. v. Bartels,* 308 U. S. 180, 60 S. Ct. 221; *American United Mutual Life Ins. Co. v. City of Avon Park,* 311 U. S. 138, 61 S. Ct. 157.

TITLE 11, SEC. 96, U. S. C. A. APPLIES TO PRIVATE BANKRUPTCY ONLY.

Section 96 has no application to this case whatever. It merely provides what a preference is so far as private bankruptcy is concerned. The four months period relates to obtaining judgments and unlawful preferences by creditors of insolvent private debtors. It seems obvious on the face of the statute itself that it does not apply in any of its operations to a public debtor nor to the municipal bankruptcy section of the bankruptcy act. See *Evergreen Farms Co. v. Willacy Co. Water Control & Impr. Dist.,* 124 Fed. (2d) 1. The preference that we are talking about in this case consists in a discrimination in favor of the California National Bank to the detriment of the appellants. Call it unequal treatment, discrimination, bad faith, it is of course a preference, but it is not good faith merely because the preferential payment was made more than four months prior to the filing of the petition for composition.

II. THE INTERLOCUTORY DECREE IN THIS CASE IS NOT GOOD BECAUSE THE COURT DID NOT FOLLOW THE MANDATORY PROVISIONS OF THE BANKRUPTCY ACT REQUIRING IT TO INVESTIGATE THE CIRCUMSTANCES SURROUNDING THE DEPOSIT OF THE SECURITIES AND THE QUESTION WHETHER FISCAL AGENTS WERE OR WERE NOT PROPERLY COMPENSATED, AND FAILED TO MAKE A FINDING AND ADJUDICATION ON THAT QUESTION.

The Court's opinion below suggests that this point is an afterthought of a "recalcitrant minority".

The Court seemed further to be impressed by the view that the plan of composition was "recommended

by 95% of the creditors". We believe that the trial Court also was unduly impressed by this factor. It is respectfully represented that a minority, regardless of how small it may be, has the undeniable right to protect its property interests. It is always a recalcitrant minority which asserts and establishes rights in a democracy, for the majority can always get its own way without such actions. In the very case of *Case v. L. A. Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, which the Circuit Court does not even mention in its opinion, where the plan was consented to by over 90% of the creditors the Court declared: "All those interested in the estate are entitled to the Court's protection", and declared that "the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one". The fact that they did so approve "is as immaterial on the basic issue of its fairness as is the fact that petitioners own only $18,500 face amount of a large bond issue". (The bond issue was nearly $4,000,000.)

The present bankruptcy act was passed August 16, 1937. (c. 657, 50 Stats. 654.) When the statute was so passed it had no provision requiring the Court to make the examination which appellants claim the Court failed to make. Appellants' answer was filed December 10, 1938. (R. 36.) The case was heard February 27, 1940. (R. 49.) At this stage in the proceedings it was Congress that had an afterthought, for on June 28, 1940, by c. 438, secs. 2, 3, 54 Stats. 668, 669, Congress amended the statute to provide that the Court should make the examination referred to. It was not

until March 8, 1941 (R. 241-263) that the Court made its findings and decree. The duty was upon the Court to make this examination, which it did not do, but should have done with view to satisfying the statute which was passed after the hearing. There was no obligation upon the appellants to object to the findings or decree on this basis. No cross findings need be submitted by the defeated parties. *Penmack Corp. v. Esterbrook Steel Pen. Mfg. Co.*, 27 Fed. Supp. 86. *Detective Comics, Inc. v. Bruns Publications, Inc.*, 28 Fed. Supp. 399. See Rule 52, Federal Rules of Civil Procedure.

While the amounts which were paid in costs and expenses could not serve to diminish the amount (as shown by the record) which the appellant was to receive by the plan, the appellants pointed out in their brief that nothing was shown e. g. as to what compensation Paul W. Curtis as Secretary of the Bondholders' Protective Committee might have obtained. (R. 88.) Nor were any of the circumstances surrounding the obtaining of the consents of the original bondholders shown to the Court. We believe it was the intent of Congress that an inquiry should be made by the Court into all these circumstances. In the case cited by the lower Court in its opinion (*American United Mutual Life Ins. Co. v. City of Avon Park*, 61 S. Ct. 157, 311 U. S. 138, the Supreme Court said:

> "The responsibility of the court entails scrutiny of the circumstances surrounding the acceptances, the special or ulterior motives which may have induced them, the time of acquiring the claims so voting, the amount paid therefor and the like.

> Only after such investigation can the court exercise the 'informed, independent judgment * * * which is an essential prerequisite for confirmation of a plan.' And that is true whether the assents to the plan have been obtained prior to the filing of the petition or subsequent thereto."

We respectfully contend that the investigation positively must be made and that in this case it was not made.

III. AS A MATTER OF LAW THE FINDINGS, DECREE AND RECORD FAIL TO ESTABLISH THAT THE PLAN IS FAIR; NOR CAN FAIRNESS BE DETERMINED FROM THE RECORD, FINDINGS OR DECREE.

There is a conflict in the opinions of the lower Circuit Court with respect to the necessity of findings to establish fairness as required by the rule in the *DuBois* case (*Consolidated Rock Products Company v. DuBois,* 312 U. S. 510).

In the case of *Lorber v. Vista Irrigation District,* 127 Fed. (2d) 628, decided by the same Court on April 16, 1942, which decision it will be noted was rendered only two weeks after the decision in the instant case, the Circuit Court pointed out that since the decisions of that Court in the case of *West Coast Life Insurance Co. v. Merced Irrigation District,* 114 Fed. (2d) 654; *Bekins v. Lindsay-Strathmore Irrigation District,* 114 Fed. (2d) 680, *Jordan v. Palo Verde Irrigation District,* 114 Fed. (2d) 691 and *Moody v. James Irrigation District,* 114 Fed. (2d) 685 (all of which decisions are cited by the lower Court in the

instant case) "The Supreme Court decided the case of *Consolidated Rock Company v. DuBois,* supra,[1] which case would indicate that in order to 'exercise the informed, independent judgment * * * which appraisal of the fairness of a plan of reorganization entails', the trial Court should make some finding to support a conclusion that the payments provided for in the plan of composition are all that the District is reasonably able to pay in the circumstances."

Subsequently in the case of *Covell v. South San Joaquin Irrigation District, No. 9788,* the same Court on April 20, 1942 (Mr. Justice Wilbur presiding) made the same ruling, refused to hear arguments on the appeal, and remanded the cause for further proceedings and to make findings on the question of the ability of the district to pay, in other words, on the question of the fairness of the plan.

The gist of this determination by the lower Court in these later cases is that the trial Court failed to find specially the facts upon which to base a conclusion of fairness of the amount offered by the plan.

The findings in the instant case are even more meager than they were in the *Vista* case or in the *South San Joaquin Irrigation District* case (R. 241 at 247); the only finding is that the "plan is fair and equitable and for the best interest of the creditors".

In the *South San Joaquin* case there was a finding (R. 151 in that case) "That the payments to be made as provided in said plan of composition are the full

[1]*Consolidated Rock Products Co. v. DuBois,* 312 U. S. 510, 61 S. Ct. 675.

amount which petitioner is able to pay on its aforesaid indebtedness". Mr. Justice Stephens (who wrote the opinions in the first group of water district cases cited above) stated at the hearing on April 20, 1942 that the Court had considered that finding and was of the opinion that it was a conclusion of law and not a finding of fact.

It will appear from the decision in the *Vista* case (supra) that the Ninth Circuit Court of Appeals did not remand the case for further hearing based upon a determination which was or could be made from the record as to the fairness of the plan. The Court definitely thought that the case should be remanded because the lower Court had failed to make findings indicated by the *DuBois* case and presumably to establish a rule for lower Courts to follow in the preparation of their findings. Subsequently, when the case of Paradise Irrigation District (*J. R. Mason, Appellant v. Paradise Irrigation District, Appellee,* No. 9925 in the United States Circuit Court of Appeals for the Ninth Circuit) came up for consideration in that same Court, an order was made remanding that case on May 14, 1942 the order reading:

> ORDER REMANDING CAUSE FOR FINDINGS, ETC.
>
> "Upon appeal from the District Court of the United States for the Northern District of California, Northern Division.
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> This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of California, Northern Division, and was duly submitted:

> On Consideration Whereof, It is now hereby ordered by this Court that this cause be, and hereby is remanded to the said District Court with directions to make specific findings bearing on the question of the maximum amount that the District is reasonably able to pay is bondholders in the circumstances, either with or without the taking of additional evidence as said District Court in its discretion may determine. See Lorber v. Vista Irrigation District, ... Fed. (2d) ..... (CCA 9 Apr. 16, 1942) Consolidated Rock Products Co. et al. v. DuBois, 312 U. S. 510, 65 S. Ct. 675. The District Court shall further clarify its findings on the question whether the plan of composition provides for deductions from the amount to be paid for coupons which have been voluntarily paid by the Irrigation District.
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> It Is Further Ordered that the submission of said cause be, and hereby is set aside. (Garrecht, C. J. does not concur.)"
>
> (..... Fed. (2d) .....)

It will be noted that Circuit Judge Garrecht who wrote the opinion in the instant case for the Ninth Circuit Court of Appeals did not concur in the order made in the *Paradise Irrigation District* case and his non-concurrence is evidently the view of Circuit Judges Wilbur[2] and Healy, who joined with him in making the order refusing to grant a rehearing in the instant case on the grounds, presumably, that in the view of the Court the record does sustain the prop-

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[2]But Judge Wilbur joined in the order in the *Covell* case, supra.

osition that 50.5 cents is all that the district is able to pay and that the case should not be remanded for failure of the findings to support this conclusion.

Here, however, is a definite, positive disagreement evidenced by the opinion of the same Circuit Court of Appeals, made May 29, 1942 in the instant case which reads:

> "Before: WILBUR, GARRECHT and HEALY, Circuit Judges:
>
> It is hereby ordered that the opinion of this Court filed in the above entitled case on the 30th day of March 30, 1942, be, and the same hereby is amended by adding to the paragraph ending on line 6, page 6 of said opinion, the following sentence:
>
> "It is apparent from the record that the amount to be paid the bondholders of 50½ cents on the dollar is all that can reasonably be paid in the circumstances."
>
> (..... Fed. (2d) .....) (R. 307.)

Petitioners urge that a review of this case should be granted.

Petitioners go further and contend that as a matter of law the record in this case cannot support a finding of fact or a conclusion of law as to fairness, because the taxpaying ability of the property in the City of Placerville was not taken into consideration and no examination was made as to the property values in this city. The entire area and real property in this city is within the El Dorado Irrigation District and is a part of the security for this bonded indebtedness. Unless it be known what the taxpaying ability is, how

can it be determined as a matter of law whether the plan is fair? As a matter of fact, the evidence in the case was based almost exclusively upon the taxpaying ability of the pear growers occupying about one-sixth of the area of the district. The Court did not seem to be interested in industries, mining, or the taxpaying ability of the City of Placerville.

Further, unless the evidence furnished the Court by a petitioner under this statute includes the customary financial statement supplied by a municipality when it enters the market to borrow money, including the assessed valuation of property subject to tax, and its estimated true value, the record of taxes levied, delinquencies, tax sales and amount realized from the sale of escheated lands, value of land acquired for delinquent taxes and unsold, revenue derived anually from tax levies, water tolls, redemptions of delinquent property, ground rents, crop shares and other sources of revenue available, how is it possible to determine as a matter of law or fact whether the money offered in a plan of composition is "fair and equitable" and "does not discriminate either for or against any creditor", especially when the bonds which it is sought to get a discharge from are held by the State Supreme Court to constitute general obligations payable from unlimited *ad valorem* taxes on all privately held land within the district boundaries, and which taxes must be levied annually at rates sufficient to pay contracts due and to become due within the year, and which taxes if not collected when due become a lien against the property taxed ranking ahead of pre-existing

mortgages and even maturing into tax title ahead of general taxes levied by other taxing[1] authorities.

Bolton v. Terra Bella Irr. Dist., 106 Cal. App. 313;

Calif. Loan & Trust Co. v. Weis, 118 Cal. 489;

Anderson Cottonwood I. D. v. Klukkert, 13 Cal. (2d) 191;

Anderson Cottonwood I. D. v. Zinzer, 51 A. C. A. 791 (Apr. 29, 1942).

Respondent, ever since 1932 has violated the mandatory laws of its creator, in that it has failed to levy the taxes at rates annually as is mandatory under Sec. 39 (Cal. Stat. 1919, p. 472).

Selby v. Oakdale Irr. Dist., 140 Cal. App. 171.

To allow the decree below to stand would be to give a windfall to every holder of a mortgage on property within this district, and also sanction many years of law violation before the filing of the petition.

Your petitioners have had no interest at all for ten years and very respectfully submit that to now be forced to take $505 for each $1000 6% bond, although not due for many years, with less than 20% of more than $600 of defaulted interest on each bond (R. 259), from a thriving community that is more than solvent, while others have been paid 82½% of principal and

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[1]The State takes 5 years to obtain tax title; Irrigation District only 3 years.

Cal. Political Code 3785;

Sec. 47, "the California Irrigation District Act" amended Cal. Stat. 1939, p. 1576.

interest, would not qualify as "fair and equitable" by any known standard, and would more correctly be branded as confiscation than composition.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should be granted, the decree of the Court below reversed, and the proceeding directed to be dismissed.

Dated, Turlock, California,
August 12, 1942.

Respectfully submitted,
W. COBURN COOK,
Counsel for Petitioners.